BUREAU OF AUTOMOTIVE REPAIR

JOINT COMMITTEE ON BOARDS, COMMISSIONS AND CONSUMER PROTECTION

December 7 Hearing
On The Initial
Report of the Bureau of Automotive Repair Administration and Enforcement Monitor

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BACKGROUND PAPER

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BACKGROUND PAPER

INTRODUCTION

Prior to 1972, there was no specific state regulation of the automotive repair industry. In 1971, after two years of legislative debate in response to consumer and industry concerns about fraud and incompetence in the auto repair business, California enacted the Automotive Repair Act (Act) through passage of SB 51 (Beilenson, Chapter 1578, Statutes of 1971). California was the first state in the nation to implement a comprehensive program for the regulation of the automotive repair industry, and enactment of the Act was supported by consumers and many organizations in the industry. The primary purpose of the Act was to protect consumers from unethical and illegal behavior by the automotive repair industry, and achieve consumer confidence in the California auto repair industry.

SB 51 mandated a statewide automotive repair consumer protection program, creating the Bureau of Automotive Repair (BAR or Bureau) as part of the Department of Consumer Affairs (DCA) in 1972. The BAR is administered by a Bureau Chief who is appointed by the Governor and confirmed by the State Senate. The Bureau Chief serves at the pleasure of the Governor and under the direction and supervision of the Director of the DCA. The Act requires automotive repair dealers (ARDs) to be registered with the BAR, and defines an ARD as a person or entity who, for compensation, engages in the business of repairing or diagnosing malfunctions of motor vehicles. The Act requires ARDs to provide written estimates, obtain written customer authorization to perform repairs, provide customers with itemized invoices that detail both the parts and labor performed, and provide customers with the parts that have been replaced on their vehicles upon request.

Except for ARDs who perform specified inspections of vehicular lighting and brake systems required by the Vehicle Code, or those who perform vehicle emission inspections and repairs (see below), there are no prerequisite educational, experience, training, or examination requirements. Automotive repair technicians (mechanics), except for those who perform the required vehicle lighting, brake or smog check inspections and certifications, are not required to be registered or licensed by the BAR, nor meet any prerequisite education, experience, training or examination requirements.

Since 1984, the BAR also has had the responsibility of administering the state's program to reduce emissions from motor vehicles, called the Smog Check Program. The Smog Check Program was enacted in 1982 by SB 33 (Presley, Chapter 892) in response to 1977 amendments to the federal Clean Air Act which required areas of the country that did not attain specified ambient air quality standards by 1982 to implement Inspection and Maintenance (I/M) programs to reduce emissions from operating cars and small trucks.

That program provides for the licensing of smog check stations and smog check technicians who are required to meet specified standards by the BAR, and generally requires motor vehicles to be inspected on a biennial basis and to meet specified emissions standards in order to be registered to operate in the State.

There are over 26 million cars and light-duty trucks registered in California. The BAR registers approximately 41,000 ARDs, and licenses approximately 2,300 Lamp and Brakes Stations, 8,600 Smog Check Stations, 15,800 Smog Check Technicians, and 4,700 lamp and brake adjusters.

In 2003 the BAR underwent sunset review by the (then) Joint Legislative Sunset Review Committee (JLSRC); the first time BAR had been reviewed by the JLSRC. After an extensive review, a number of significant issues were raised with the Bureau's administrative structure and enforcement practices. As a result the Legislature enacted SB 1542 (Figueroa, Chapter 572, Statutes of 2004).

Among other things, SB 1542 required the Director of Consumer Affairs (Director) to appoint a Bureau of Automotive Repair Administration and Enforcement Monitor (Monitor) by January 3, 2005, to "evaluate the bureau's disciplinary system and procedures, with specific concentration on improving the overall efficiency and assuring the fairness of the enforcement program, and the need for administrative structural changes" (Business & Professions Code (BPC) Section 9882.6 (c) (1)).

The Director selected David Howe of Strategica, a company based in Washington State, as the Administration and Enforcement Monitor.

SB 1950 required the Monitor to submit an initial written report of findings and conclusions no later than July 1, 2005, and every six months thereafter; and requires the Monitor to issue a final report prior to December 31, 2006.

In October 2005, the Monitor issued its 53-page ("Draft 10/18/05") "*Initial Report: Bureau of Automotive Repair Enforcement Monitor*" (Report) to the Joint Committee on Boards Commissions and Consumer Protection (JCBCCP). This hearing is convened to hear testimony about the Report.

As described in greater detail below, the initial Report ("initial" because it is the first of three reports) identifies a number of issues in the Bureau's enforcement program.

The Report further provides a number of detailed recommendations for addressing the issues identified. Members of the JCBCCP have been provided a copy of the actual Report, but this Background Paper offers a summary of the Report's major findings and recommendations and a legislative perspective.

MONITOR REPORT'S FINDINGS AND RECOMMENDATIONS

The Monitor focused his investigatory work upon six key questions. The Monitor states that the questions incorporate the objectives of the enabling legislation (SB 1542) as well as stakeholder expectations. The questions are:

1. Does the BAR disciplinary process provide for due process?
2. Should the Act include a specific definition of fraud?
3. Are regulators enforcing documentation and paperwork standards that don't exist?
4. Is the system of sanctions commensurate with the degree of violation?
5. Should the BAR be in the business of setting and enforcing trade standards?
6. Is the BAR doing enough to prevent violations other than applying sanctions?

Question # 1: Does the BAR disciplinary process provide for due process?

The Monitor states that the BAR disciplinary system has come under criticism from industry for being stacked against licensees involved in investigations and disciplinary actions. These criticisms include:

Non-Adoption of Administrative Law Judge Decisions. Under the Administrative Procedure Act (APA) – Chapters 4.5 and 5 of Part 1 of Division 3 of the Government Code (§§ 11400-11529) – proposed decisions, made by Administrative Law Judges (ALJ) after an administrative hearing, may be rejected by the Director of DCA and a new decision can be adopted. Members of industry and the defense bar argue that this "non-adopt" provision, creates a natural bias against the licensee's case because the mission of DCA is consumer protection. It is further argued that the non-adopt provision creates a disincentive for a licensee to seek a hearing in order to disprove the allegations, or more typically, to provide mitigating circumstances at a hearing in order to seek a reduction of the penalty. In addition, because the DCA Director is not present at the administrative hearing, a final decision is rendered without the benefit of hearing testimony first-hand or observing witnesses.

Other barriers to seeking a fair hearing. Additional issues have been raised as barriers to a licensee seeking a fair hearing in a disciplinary case. These are summarized as:

1. The licensee does not have the ability to recover costs incurred for the defense of a disciplinary case, even when the licensee prevails against the Bureau.

2. Cost recovery – the licensee is required to pay the BAR's investigation costs for a disciplinary case.

3. The options for discovery available to a licensee under state law are restricted.

4. The Act's record inspection provision is considered to be heavy-handed and a violation of due process.

In considering what due process is required in regulatory systems such as the BAR, the report cites various courts including the U.S. Supreme Court, and summarizes:

- States may condition the right to enter a profession or trade if there is a compelling public interest. Under this scenario the right becomes more of a privilege and the license is subject to the rules of the regulatory program.

- The federal Constitution does not guarantee full due process in administrative hearings. Only notice and the right to a hearing are guaranteed. However, regulatory schemes and their administration cannot be unreasonable, arbitrary or capricious.

- Case law allows an agency head to adjudicate a case falling within his or her jurisdiction despite the appearance of a conflict of interest. The law assumes that agency adjudicators are impartial in the absence of evidence to the contrary.

- Warrantless searches, which is what BAR program representatives do during record inspections, are legal insofar as the statute authorizing them supports a legitimate regulatory interest of the state and there are sufficient safeguards against the searches getting out of hand.

The Monitor's case auditing found that the BAR staff conducted the program in a professional but firm manner; cases were well prepared and field staff conducted themselves appropriately.

In disciplinary cases that go to hearing and in which an Administrative Law Judge renders a proposed decision, the Administrative Procedure Act provides that the agency may "reject the proposed decision [of the Administrative Law Judge], and decide the case upon the record" (Government Code § 11517(c)(2)(E)). According to the Report, about 10% of the proposed decisions are non-adopted. Of those decisions which are non-adopted, the decision adopted by the DCA results in a greater penalty in 17 of the 26 non-adopt decisions in the last 3 years (65%). The Report concludes that the increased penalties lend credence to industry concerns that a hearing is risky and will not be fairly adjudicated.

Monitor Recommendations: The Monitor has recommended several steps to improve some of the due process safeguards even though the current system may be found to be constitutional:

1. **Exclude the use of the non-adopt option in BAR disciplinary cases**, thus making the ALJ's proposed decision the final decision in a disciplinary case that has gone through the administrative hearing process. The Monitor states the non-adopt option helps create a stacked system, is infrequently used, and creates a barrier for licensees seeking a fair hearing on a licensure issue.

2. **Amend the law to allow licensees to recover legal fees** if a substantial majority of allegations in an accusation are not proven. Although BPC § 125.3 allows the Bureau to recover the cost of investigating a case if the allegations are proven, there is no provision for a respondent to recover the cost of its defense even if none of the allegations are proven. This significantly limits access to the judicial system for a respondent and increases the probability that a respondent will settle the charges rather than challenge them in a hearing.

3. **Strengthen the role of the Industry Ombudsman** to have greater authority and independence in investigatory and discipline matters. In 2003, BAR established an Industry Ombudsman to handle specific complaints and concerns brought forth by the industry regarding mediation, consumer complaints, investigations or disciplinary proceedings. The idea was that the ombudsman would be able to address industry concerns about BAR processes and be able to resolve matters that were deemed to be handled unfairly or unprofessionally. Currently the individual appointed to this position also supervises one of the four mediation centers operated by DCA. The Monitor states that the authority of the ombudsman is not well defined and it is unclear how much discretion or power the position has to resolve matters.

   The Monitor recommends that the Industry Ombudsman should report directly to the Director of DCA and should not be encumbered with other duties that would involve another reporting relationship. The Ombudsman should have the ability to investigate any report of unreasonable or arbitrary conduct and have access to any documentation regarding an open or closed investigation or disciplinary matter. The Ombudsman should report any unreasonable or arbitrary conduct to either the DCA Director or the Special Operations Unit of DCA.

Question # 2: Should the Act include a specific definition of fraud?

The Automotive Repair Act includes several actions that are grounds for sanctioning or revoking a license. Two of these acts enter into the realm of constructive fraud. Constructive fraud is similar to actual fraud except it doesn't require the element of intent to defraud. Constructive fraud usually occurs in a context of a fiduciary or contractual relationship (e.g., an auto repair transaction) where there is a presumed duty to disclose any information that would impact the transaction (e.g., the true condition of the vehicle).

The problem with these provisions is that they can potentially snare one-time mistakes in the same net as more insidious, repeated acts of constructive fraud. Unless the agency can determine whether the "mistakes" are part of a pattern it is difficult to tell the difference.

Because California law other than the Automotive Repair Act applies the concept of constructive fraud on the auto repair industry (i.e., the Civil Code applies the concept to contracts), it is hard to argue that the concept applies in some situations, such as the validity of a repair contract, but not other situations, such as the licensee's fitness to hold the license.

A bigger issue is the difficulty of understanding the concept of constructive fraud, how the line is crossed between honest mistake and constructive fraud, and how to avoid crossing that line.

Monitor Recommendations: The Monitor has recommended that the concept of constructive fraud should be clarified, and suggests that clarification could be made in several ways:

1. **Amend BPC Sections 9884.7 and 9884.7 to include specific examples of violations** with a qualifier that the examples are not exhaustive or all-encompassing.

2. **Expand BAR educational materials**, such as the *Write-it-Right* series of publications, to include descriptions on what fraud is (both types), what "reasonable care" entails, real-world examples of how ARDs get into trouble with the fraud statutes, simple steps and safeguards for running a business, operating work order systems, etc. while avoiding committing fraud violations. This can also be accomplished through a program of basic licensee training.

Question # 3: Are regulators enforcing documentation and paperwork standards that don't exist?

This question concerns whether BAR is enforcing rules that are divorced from the original intent of the Act and the Health and Safety Code. The Monitor states that these two statutes include many seemingly persnickety rules and regulations covering such things as what information goes into a work estimate, what a smog technician is supposed to do under the hood of a car, etc. Industry criticism suggests that some of these rules are not only irrelevant but they constitute scope creep from the original intent of the law which was intended to go after the bad operators and leave the good ones alone.

While many of these laws have been in the Code since the law was first enacted, it should be understood that the laws do serve a purpose. Documentation standards that require things like the correct address of an ARD on an invoice are intended to improve communication between ARDs and their customers so that the scope of potential

problems and disputes is narrowed down to more substantive issues such as workmanship and fraud.

The Monitor points out that the greater issue may be that systems used to generate estimates and other documentation frequently are inadequate to fully comply with the requirements of the law. In addition, many ARD operators are either unaware of or don't acknowledge the rules.

Monitor Recommendations: The Monitor has recommended implementing a mandatory minimal training course in the requirements of the Automotive Repair Act as a condition for ARD licensing.

Question # 4: Is the system of sanctions commensurate with the degree of violation?

The Monitor reviewed a limited number of disciplinary actions to determine:

1. Do non-adopt decisions result in greater sanctions?

2. Do cases get resolved with greater sanctions than the guidelines allow?

3. Do cases get resolved with greater sanctions than the facts would warrant?

The review found:

- Non-adopt decisions frequently result in greater sanctions (17 out of 26 non-adopt cases over the last three years). The Monitor states that this lends credence to industry concerns that a hearing is risky and will not be fairly adjudicated.

- All cases are resolved within guidelines and are even frequently sanctioned less than the guidelines. In fact, three of the non-adopt cases in the sample were ultimately decided at less than what the guidelines call for.

- In nearly all cases, the sanctions applied appeared to match the severity of the proven allegations and were consistent with other cases with similar facts and circumstances.

Monitor Recommendations: As previously stated the Monitor recommends that the law should be amended to exclude the Automotive Repair Act from the use of the non-adopt provision, thus making the ALJ's proposed decision the final decision in disciplinary cases that have gone to an administrative hearing.

Question # 5: Should BAR be in the business of setting and enforcing trade standards?

While the Automotive Repair Act and the Health and Safety Code are mostly silent on what constitutes trade standards, BAR may take disciplinary action against an ARD for "Any willful departure from or disregard of accepted trade standards for good and workmanlike repair in any material respect . . ." (BPC § 9884.7(a)(7)).

The Report cites two ways in which trade standards become relevant for purposes of taking disciplinary actions against licensees:

- **When there is disagreement over trade standards.** A typical example is where an ARD allegedly oversells brake repair work such as wheel cylinder or caliper replacement where only a disk or pad replacement was needed. In this case, a "willful departure from accepted trade standards" could be cited because an accepted standard would be to not replace wheel cylinders or calipers unless they were not operating correctly (e.g., leaking brake fluid). Some technicians, however, insist that brake calipers should be replaced more frequently than traditionally called for.

- **When trade standards are used to document violations.** Trade standards are relevant when cars are documented for undercover operations. In such instances, cars are prepared with an induced operating problem or the condition of a component is checked against some standard such as manufacturer specifications. The technician preparing the vehicle for an undercover operation will prepare a statement citing the condition of the vehicle, often stating that a component or part was verified to be within trade standards (e.g., the thickness of a brake rotor). If an ARD then states that the component is not operating correctly or needs repair it may become the basis for an allegation of a departure from trade standards.

One solution could be to define what the trade standards should be in statute. However, the Monitor states that this would eliminate discretion for repair technicians and vastly expand the scope of BAR's regulatory activities.

The Monitor states that a concern of industry is that if trade standards are not defined in statute, then ARDs are being held to an undefined standard when diagnosing and repairing vehicles. Honest mistakes or differences of professional judgment can get caught up in the same net as truly fraudulent behavior. According to the Report, the key seems to be finding a way to separate these two classes of conduct rather than establishing a defined standard in the statute that would completely eliminate any discretion on the part of ARDs. Separating these two classes should be the task of investigators so that only cases involving fraud (including constructive fraud) should be disciplined.

Should an error be made at the investigatory stage and a case involving an honest mistake or a difference in professional judgment reach the stage of an administrative hearing, then an ALJ should be able to make this distinction and reflect it in the findings. A significant

flaw with this safeguard is that most ALJs do not specialize in a particular area of government. This makes it difficult for ALJs to develop the expertise in auto repair matters to be able to separate the trade standard violations from the differences in professional judgment. A dedicated panel of ALJs would help to improve this safeguard, according to the Report.

Monitor Recommendations:

1. **Create a specialized panel of ALJs within the Office of Administrative Hearings (OAH) to better adjudicate BAR cases** especially those that deal with tricky issues such as trade standards.

2. **Implement recommendations from the *Auto Body Repair Inspection Pilot Program Report to the Legislature***. These recommendations include:

    a. Consider requiring that those who have the mechanical background and equipment to properly evaluate the true condition of the vehicle do the formal estimating of collision damage.

    b. Documents produced by insurance adjusters should be identified and explained as a "visual damage assessment."

Question # 6: Is BAR doing enough to prevent violations other than applying sanctions?

The Report states that one area where the Repair Act is lacking enforcement capability is in licensing service writers, managing employees, and beneficial owners of ARDs. The current system of registering business entities is sometimes unable to prevent violators from re-entering the industry under another guise.

The Monitor suggests that the ARD license should be structured more in line with how smog check licenses are issued where actual operators are licensed in addition to the business. Key individuals should be required to take a short class on BAR standards, pass a test, be issued a license and be subject to discipline in the event of violations. Existing licensees should be required to take the course and pass a test as a condition for continued licensure. This system would:

- Help ensure a minimal level of proficiency without costing industry much down time

- Build licensee's awareness of what the standards are, how they can be complied with, the business benefits of compliance, and how the BAR operates

- Provide a greater incentive to adhere to the Auto Repair Act and the H&S Code because individuals will be personally accountable for their actions in addition to the business entity

- Allow more accurate targeting of sanctions to the responsible parties. This can be a real advantage when addressing a large ARD like a dealership

- Provide that those who financially benefit from violations can be disciplined with more consistency than is currently the case.

Monitor Recommendations: Establish a system to teach and test for minimal proficiencies. Passing the test should be a condition for obtaining a BAR license. Then when violations occur, BAR would be able to target disciplinary efforts at responsible individuals as well as at business entities. This allows the BAR to do selective targeting of disciplinary efforts. For example, rather than be faced with the dilemma of revoking the license of a large dealership and making all employees unemployed, the BAR could suspend or revoke the license of a service writer, fine the beneficial owner, and put the business license on probation. In cases where misconduct is a business-wide strategy, all licenses could be sanctioned.

The Monitor recommends that BAR's current education programs and licensing system should be augmented as follows:

1. **Education and examination program.** Require all ARD employees who prepare estimates, work orders, follow-up estimates and invoices (called service writers) to attend an 8-hour course and pass a test as a condition for receiving a license. Require existing licensees to take the course and the test within a staggered three-year period. The course would cover:

    - Documentation requirements as found in BAR's *Write-it-Right* publications
    - BAR's disciplinary system
    - Sources of information that would help licensees comply with state law
    - Basic legal information about fraud, constructive fraud and fraud prevention
    - Other responsibilities of holding a BAR license.

2. **License service writers.** All service writers should be required to hold a BAR license. This license would be subject to discipline in the same manner as current ARD registrations and smog check licenses including revocation.

3. **License owners and responsible managers.** At least one individual who has a financial stake in an ARD or smog check business and any managing employee who has a financial stake should be required to also hold a BAR license. This license would be subject to discipline in the same manner as current ARD registrations and smog check licenses including revocation.

INDUSTRY CONCERNS

The Automotive Repair Coalition (ARC) has expressed to the Joint Committee its support of the Monitor's work and the issues raised in this initial Report. ARC believes that the Monitor has made significant progress in understanding the complex nature of the Bureau's structure and regulatory operations in the six months that the Monitor has been reviewing BAR. The ARC has also expressed concern that the Report does not focus to a greater degree on BAR's administrative structure, and on ways in which collaborative relationships can be formed between BAR and the industry in order to best serve consumers and eliminate bad operators from the market place. ARC has expressed its desire for the Monitor to more fully enter into these issues as this two-year project goes forward.

QUESTIONS FOR THE COMMITTEE

1. The Report recommends that the Administrative Procedure Act provision for an agency to reject the Adminstrative Law Judge's proposed decision and render its own decsions (called "non-adopt provision") be eliminated for BAR administrative disciplinary cases In reviewing disciplinary cases, what are the reasons found for why DCA did not adopt the proposed decision? Do these no-adopted decisions indicate a biased decision-maker? Does the finding suggest that there is a prevalence of ex parte communication regarding disciplinary cases? Does the finding suggest that there is a significant number of mistakes made in decisions proposed by Administrative Law Judges?

2. The Report recommends eliminating the non-adopt provision for BAR disciplinary cases. The non-adopt provision is part of the due process provisions of the Administrative Procedure Act. What findings were made by the Monitor to the BAR's administrative structure or its enforcement processes which shows that the use of the non-adopt provision is be inadequate of unjust?

3. (For DCA) News releases by DCA about accusations or other disciplinary actions being initiated by DCA Bureaus against licensees contain direct quotes attributed to the DCA Director. In light of industry concerns about an unbiased decider, what are the current safeguards which ensure that the Director remains unbiased in BAR cases?

4. If the non-adopt provision was removed for BAR disciplinary cases, what would happen in cases where there are obvious substantive errors in the Administrative Law Judge's decision?

5. What would be the fiscal impact to the Bureau of allowing licensees to recover legal fees in disciplinary cases in which the licensee prevails?

6. The Report recommends licensing (education, examination, licensure) all service writers, and automotive repair dealer owners, and managers as a preventive measure in order to prevent violation (to improve competence within the industry and

compliance with the law). What other alternatives were considered to the recommendation? Will creating a new regulatory and licensing function for the BAR resolve the education issues? What are the estimated costs and resources necessary to implement this recommendation?